



Posted on: December 1, 2011

MODERN WILL PLANNING WITH TESTAMENTARY TRUSTS

December 2011

By RBS Lawyers

prepared for The Advocis, Business In Vancouver supplement

As an alternative to outright bequests in a Will, a testamentary trust can address a host of estate planning objectives. Traditionally it's been a vehicle of choice when providing for beneficiaries either disabled or considered spendthrifts. More and more however, testamentary trusts are established to meet broader, more strategic, and enduring family goals.

A "testamentary trust" will take effect after the creator of the trust has passed away, and is typically created by a Will, but can also arise from insurance or RRSP/RRIF proceeds. A "discretionary trust" permits trustees to pay varying amounts to one or more beneficiaries as they see fit. The use of a testamentary trust in a Will, so that it is also a discretionary trust, can provide a powerful combination for beneficiaries.

Consider the hypothetical Mr. and Ms. Smith, who have one adult daughter, Suzanne, who has two minor children. In reviewing their family objectives with an estate professional, Mr. And Ms. Smith determine that on a last-to-die basis their remaining assets should be left to Suzanne in a testamentary discretionary trust (the "Suzanne Fund"). Suzanne will be the trustee and she and her children will be the beneficiaries. This testamentary trust planning would provide the following benefits:

1. asset protection;
2. income splitting; and
3. control and flexibility.

1. Asset Protection

With a discretionary trust, a beneficiary has no direct ownership interest in the assets of the trust. As such, it can be very difficult under normal circumstances for any third party creditor to attempt to claim or seize a beneficiary's interest under such a trust. This would provide Mr. and Mrs. Smith peace of mind that Suzanne's inheritance will not necessarily be executed upon if Suzanne had previous judgements against her or if she were in an occupation at greater risk for litigation.





2. Income Splitting

Income splitting is a process of shifting income from the hands of one taxpayer to another or others who may pay tax at a lower rate, which can produce significant savings. A testamentary trust is considered a separate taxpayer and will be taxed at the same graduated tax rates as an individual, although no individual tax credits may be claimed.

Suzanne already makes \$73,000/year from her employment, and her inheritance is expected to be \$500,000. If she received this inheritance directly and placed it into guaranteed investments earning 5% per year, she would make an additional \$25,000 personally each year from her inheritance, on top of her salary. This extra income would be taxed at the 32.5% to 38.3% combined federal and BC rates for 2011, causing Suzanne to incur an additional \$8,990 each year in extra income tax.

By contrast, if Suzanne received the same \$500,000 in the Suzanne Fund, instead of outright, and the Fund earned the same amount of \$25,000 per year, the resulting tax payable would be only \$5,025 at the combined rates. This is because the extra \$25,000 would be taxed in the lowest tax bracket (20.1% for income up to \$36,146 for 2011). The overall tax savings would be almost \$4,000 annually (\$8,900 - \$5,025 = \$3,965) between the two inheritance methods. While a tax return would need to be filed annually for the Fund, the savings would still be significant every year.

The Suzanne Fund could reduce taxes further by dividing its income among beneficiaries who have little or no income of their own. For example, the basic personal amount (\$10,527 in 2011) could be allocated to each of Suzanne's two minor children. Providing those children had no other income, they would have no tax payable on the amounts claimed on their returns. The income amount to the children of \$21,054 (\$10,527 x 2) could then be deducted from the Suzanne Fund's income of \$25,000, which would bring the amount of tax owing down from \$5,025 to a mere \$793 (\$25,000 - \$21,054 = \$3,946 x 20.1%).

3. Control and Flexibility

Suzanne would be the trustee of the Suzanne Fund, a discretionary trust, which would give her the power to decide which beneficiary or beneficiaries would receive amounts, how much, and when. Furthermore, the longevity expected for the Fund is Suzanne's lifetime, and therefore this Fund should have flexible provisions for long term operational use. Examples of such provisions could include giving Suzanne the power to appoint future trustees if she could no longer act, and providing Suzanne with the ability to direct the distribution of the Suzanne Fund upon her death.

Conclusion





RICHARDS
BUELL
SUTTON^{LLP}
Established in 1871

The use of testamentary trusts can provide many advantages, permitting beneficiaries of all kinds to receive their inheritance in a better vehicle, and we recommend that their use be explored in Will planning.

Rick Montens is a partner with BC's Oldest Law Firm - Richards Buell Sutton LLP. He is the leader of the firm's Wealth Preservation Department, specifically dealing with Estate & Trust Administration and Personal Estate Planning. Rick can be reached at 604.661.9245 or rmontens@rbs.ca.



VANCOUVER OFFICE:
700 - 401 W GEORGIA STREET
VANCOUVER, BC CANADA V6B 5A1
TEL: 604.682.3664 FAX: 604.688.3830

SURREY OFFICE:
200 - 10233 153 STREET
SURREY, BC CANADA V3R 0Z7
TEL: 604.582.7743 FAX: 604.582.7753

RBS.CA